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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

v.

SYLVIE R. GRIFFITHS,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

WILL R. GREGG,
ALLIN H. PIERCE,
Counsel for the Respondent.

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Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 11) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 20) is reported in 129 F. (2d) 321.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on July 20, 1942 (R. 20). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

I.

Does a stock dividend of common shares upon common shares, where there is no other class of stock outstanding, constitute income within the meaning of the Sixteenth Amendment?

II.

Was such a stock dividend taxable as income under the Revenue Act and Treasury Regulations which were in effect during the year 1939?

III.

Assuming *arguendo* that both of the above questions are answered in the affirmative, what amount should be included in the taxpayer's gross income on account of the stock dividends here involved?

Constitutional Provisions, Statute and Regulations Involved.

The material provisions of the Constitution and most of the material provisions of the Statute and Treasury Regulations are set forth in the Appendix of the Commissioner's Brief (pp. 7-10). Additional provisions deemed material are cited in the Argument *infra*.

Statement.

This case involves an alleged deficiency in income tax for the year 1939, asserted against Sylvie R. Griffiths, the respondent in this court.

The facts of the case are set forth in the petition filed by the taxpayer with the Board of Tax Appeals (R. 3-9). All facts alleged in that petition were admitted by the Commissioner in his answer (R. 10) and the case was submitted for decision upon the pleadings.

The more important facts are summarized in the Board's opinion (R. 11):

> "The Commissioner determined that stock dividends of common shares received by the petitioner in the taxable year upon shares which she owned of exactly the same class and kind, there being no other or different stock outstanding, were income to the extent of their value.
>
> "The determination is reversed."

Argument.

I.

No issue respecting the taxing powers of Congress is presented.

The petition for certiorari suggests that the issue in this case pertains to the power of Congress to tax stock dividends constitutionally and to lay such tax without apportionment. On page 2 of the petition it is stated that the question is whether a stock dividend of the type described "is constitutionally subject to tax without apportionment"; and on page 6 of the petition the first error specified is that the court below erred "in holding that the stock dividends could not constitutionally be subjected to tax."

It is respectfully submitted that such issues are not presented by the record in this case, and that the only questions involved pertain to the construction of the Reve-

nue Act of 1938 and provisions of the Sixteenth Amendment referred to in Section 115 (f) of that statute.

The only tax claimed by the Commissioner in his notice of deficiency herein was additional income tax for the year 1939 (R. 8-9). The taxpayer appealed to the Board of Tax Appeals on three grounds: (1) that the stock dividends in respect of which the Commissioner claimed the additional income tax were not properly includible in gross income; (2) that they did not constitute income to the taxpayer within the meaning of the Sixteenth Amendment; and (3) that, in the alternative, if any amount were includible in gross income in respect of the stock dividends, the amount included by the Commissioner was incorrect (R. 3-4).

All facts alleged in the petition were admitted in the answer and the case was submitted for decision on the pleadings. The Board reversed the Commissioner's determination that the stock dividends "were income to the extent of their value" (R. 11); and the Board's decision was affirmed by the Circuit Court of Appeals in a *per curiam* opinion (R. 20). Thus no issue pertaining to the taxing powers of Congress was raised by the pleadings or decided below. The taxpayer conceded in her brief below, and she also concedes here, that Congress does have power to tax income; and the Sixteenth Amendment expressly provides that taxes on income may be laid without apportionment.

The present case differs from *Eisner* v. *Macomber*, 252 U. S. 189 (1920), in that there the provisions of the applicable statute made it necessary for the Court to consider not only the construction of the term "income" as used in the Sixteenth Amendment but also the power of Congress to tax stock dividends even if they were not income within the meaning of the Amendment. The Revenue Act of 1916, which was involved in the *Macomber*

case, provided in Section 2 (a) (see quotation from the Act set forth in the footnote on page 200 of the *Macomber* case) that a stock dividend "shall be considered income, to the amount of its cash value." In contrast, the Revenue Act of 1938 here involved provides in Section 22 (c) that "distributions by corporations shall be taxable to the shareholders as provided in Section 115"; and, in Section 115 (f) (1) it provides that "a distribution made by a corporation to its shareholders in its stock * * * shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

The present case, therefore, presents no challenge to those holdings in *Eisner* v. *Macomber* which pertain to the power of Congress to tax stock dividends other than as income. The issue is limited to the construction of the Revenue Act of 1938 and the provisions of the Sixteenth Amendment which are expressly referred to in Section 115 (f) of that statute.

II.

The principle that a stock dividend in common stock on common stock is not income within the meaning of the amendment has been long established. There is no conflict of decisions.

In *Eisner* v. *Macomber, supra,* this Court, in a carefully considered opinion which reviewed practically all possible arguments on the subject, decided that a stock dividend distributed by a corporation in its common shares to its then common shareholders, there being no other class of stock outstanding, did not constitute income to the shareholders within the meaning of the Sixteenth Amendment. Soon thereafter, in a series of other

decisions, the Court pointed out the distinction between taxable and non-taxable distributions. *United States* v. *Phellis*, 257 U. S. 156 (1921); *Rockefeller* v. *United States*, 257 U. S. 176 (1921); *Cullinan* v. *Walker*, 262 U. S. 134 (1923); and *Marr* v. *United States*, 268 U. S. 536 (1925). At a still later date, in *Koshland* v. *Helvering*, 298 U. S. 441 (1936), the Court specifically defined the application of the rule of the *Macomber* case as follows (pp. 445-446):

> "Under our decisions the payment of a dividend of new common shares, conferring no different rights or interests than did the old,—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old,—does not constitute the receipt of income by the stockholder. On the other hand, where a stock dividend gives the stockholder an interest different from that which his former stockholdings represented he receives income."

For more than twenty-two years the *Macomber* case has stood as the controlling authority on the taxability of stock dividends. Its basic rule has been recognized uniformly by the courts, the Board of Tax Appeals, the administrative authorities and the Congress. Corporations have changed their capital structures and determined the amounts of their undistributed surpluses in accordance with the rule. And, undoubtedly, thousands of shareholders have computed their income tax liabilities and filed their tax returns in reliance upon what they believed was a settled principle of law.

There is no conflict of decisions. The cases of *Helvering* v. *Sprouse*, October Term, 1942, No. 22, and *Strassburger* v. *Helvering*, October Term, 1942, No. 66, pertain

only to the applicability of the rule of the *Macomber* and *Koshland* cases to the particular stock dividends there involved; in neither case did the court below question the soundness of the basic rule as applied to facts like those here present.

It is respectfully submitted that if any change in the long established rule of the *Macomber* case is necessary or desirable, such change should be made by the Congress.

III.

Congress, in enacting the Revenue Act of 1938, did not impose income tax upon stock dividends of the type here involved. Treasury regulations in effect during the taxable year stated that such stock dividends were not taxable.

Eisner v. *Macomber, supra,* was decided March 8, 1920. Soon thereafter Congress enacted the Revenue Act of 1921 which provided in Section 201 (d): "A stock dividend shall not be subject to tax * * *." A similar exemption was provided in all subsequent Revenue Acts applicable down to the year 1936. Section 201 (f) Rev. Acts 1924 and 1926; Section 115 (f) Rev. Acts 1928, 1932 and 1934.

On May 18, 1936 this Court decided *Koshland* v. *Helvering, supra,* in which it said (p. 445):

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921."

Thereafter, on June 22, 1936, there was enacted the Revenue Act of 1936, which provided:

"115 (f) STOCK DIVIDENDS—

"(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

It will be observed that the above statute is worded in the negative and that it does not provide that every stock dividend is taxable. To the contrary, the succeeding paragraph (Section 115 (f) (2)) refers to a distribution of stock "of a class which * * * would be exempt from tax under paragraph (1)". The construction intended to be applied to the statute is shown in the following discussion had in the House of Representatives at the time the bill was pending (Cong. Rec., Vol. 80):

"Mr. Vinson of Kentucky. * * * Coming now to stock dividends, this is a field that has more or less been surrounded with mystery. Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill. There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of Eisner versus Macomber.

"The kind of securities issued and the change in the proportion of ownership of a person in a corporation are the determining factors as to whether or not it is taxable income under the sixteenth amendment. * * *

"It is our purpose to allow as a dividend credit distribution in stock of corporations, or in rights to

acquire stock of a corporation which constitutes income to the shareholder within the meaning of the sixteenth amendment. In no sense is this an attack upon the Eisner against Macomber decision * * * (pp. 6214-15).

* * * * * * * * *

"Mr. Vinson of Kentucky. * * * The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder" (p. 6309).

* * * * * * * * *

"Mr. Treadway. * * * I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

"Mr. Vinson of Kentucky. That is correct" (p. 6310).

The above discussion indicates that Congress acquiesced in the rule of the *Macomber* and *Koshland* cases and did not intend to tax stock dividends of the character here involved. The implication is clear that such distributions were not intended to be recognized either as "dividends" or as "income" within the meaning of the statute.

The Treasury Department adopted this construction in promulgating Regulations 94 relating to the 1936 Act. In Article 115-7, it stated:

"A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old

> representing the same proportionate interest in the net assets of the corporation as did the old."

It then inserted in the regulation "Example (2)" to illustrate the character of such stock dividends, and concluded as follows:

> "The stock so distributed does not constitute a taxable stock dividend to the shareholders."

In 1938, while the foregoing Regulations were in force and such construction was being applied, Congress re-enacted the provisions of section 115 (f) of the 1936 Act, without change, as section 115 (f) of the Revenue Act of 1938. The Treasury Department then promulgated Regulations 101, relating to the new Act, and included therein, as Article 115-7, the precise provisions of the corresponding article of Regulations 94.

This regulation relating to the Revenue Act of 1938, which is the Act governing the present case, continued in full force and effect until January, 1942, when it was amended so as to delete the statements above mentioned (Petn. for Cert., pp. 9-10). The amendment was made subsequent to the issuance of the deficiency notice herein (R. 8), more than two years after the stock dividends here involved had been declared and distributed, and nearly two years after the time the respondent's tax return was filed.

It is respectfully submitted that the intention of the Congress in regard to the taxation of stock dividends was clear and was correctly embodied in the Treasury Regulations construing section 115 (f) of the 1936 Act, and that when Congress re-enacted the provisions of that section as part of the 1938 Act it must be taken to have approved the administrative construction and thereby to have given it the force of law. *Helvering* v. *R. J.*

Reynolds Tobacco Co., 306 U. S. 110, 115 (1939). The attempt of the Treasury to change the existing law, retroactively, by amending its regulations in January 1942 should not be approved.

CONCLUSION.

The petition for certiorari should be denied.

Respectfully submitted,

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November 10, 1942.